**MODERATOR**

Good day and welcome to the Magnit Q2 and H1 2020 Trading Update and Financial Highlights Conference Call. Today's conference is being recorded. At this time, I would now like to turn the conference over to Mr. Albert Avetikov. Please go ahead, sir.

**ALBERT AVETIKOV**

Thank you, Carrie. Good evening, good afternoon and good morning, ladies and gentlemen! Thank you for joining us to discuss Magnit operating and unaudited financial results for the second quarter of 2020. With me to review the results are our CEO Jan Dunning, and acting CFO Dmitry Ivanov. The announcement and presentation are available on our website. And after our remarks, we look forward to taking your questions.

I would also like to remind you that today's financial results are based on the management accounts.

I will now turn the call over to Magnit CEO Jan Dunning. Jan, please.

**JAN DUNNING**

Yes, thank you, Albert, and good day, everyone. Thanks for joining. Now, of course, these external circumstances we are in currently are extraordinary challenge for the business while they provide new opportunities at the same time. We had to react fast, adopt our shop to new trends and find efficient solutions: health and safety measures, availability of assortment, service level, proper offering and relevant pricing. All these factors were crucial to adjust to a quickly changing customers' behavior and competitive landscape.

Our businesses model once again showed its resilience towards these headwinds. And overall, the results of the quarter exceeded our expectation with business performance moving now in line with our most optimistic internal scenario. All formats showed increasing sales density driven by positive like-for-like (LFL). This was driven not by lots of new square meters entering the panel but qualitative improvements in our existing network. We see consumers appreciating our offer, service level and pricing. We're actively gaining customers and market share supported by better NPS scoring.

This comes in a combination with efficiency improvements, resulting in better gross margin and savings on the cost side. And this leads to profitability of 7.9%, the highest level for the last three years.

Importantly, growth in sales and availability came without inventory increase, another zone of our strong focus this year.

We're making good progress in strengthening our balance sheet and cash flows, which builds good platform to enter next phase of our turnaround with focus on strong financial position.

Moreover, we made a huge step forward to systemize and institutionalize our approach towards sustainability. In the end of June, we announced our sustainability strategy with goals and commitments to be achieved by 2025.

Now, let me take you through the key highlights for the quarter before we move into the details. Selling space growth slowed down to 5% due to high base of the previous year. Sales growth by far outpaced selling space growth and stood at 14% driven by stronger trading in the like-for-like stores and the gap between selling space growth and sales growth has increased compared to

the first quarter. Sales densities are improving for the second consecutive quarter across all formats. Sales growth remains double-digit in each month of the quarter despite slower expansion and lower promo activity. Like-for-like sales growth was positive across all formats and all regions for the second consecutive quarter. Despite traffic turning negative in the second quarter due to the lockdown measures, it was by far overcompensated by strong average ticket dynamics. With restriction easing during the quarter, we also noted traffic gradually recovering and also in July, improving the traffic situation. This is a very good evidence of improved category management. And we saw strong correlation between improvements demonstrated in on-shelf availability, service level, rotation of personnel and higher scoring of satisfaction rates and NPS. Gross profit margin improved by 58 bps due to lower promo activity, a better promo coverage by the suppliers, improved promo margin therefore, lower shrinkage, more efficient supply chain and favorable format mix. SG&A costs as a percentage of sales significantly improved by 103 bps fully compensated, compensating actually the COVID-related costs, which amounted for RUB 1.5 billion in the second quarter. And this improvement reflects a higher sales density, increased personnel productivity, more efficient marketing costs and lower rent expenses. With this, EBITDA stood at 7.9 showing solid recovery for the second consecutive quarter both y-o-y and q-o-q. Net finance costs were 10% lower following a reduction of cost of debt to 6.3%. And as a result, our net income doubled with a margin of 3.3%. The total debt at the end of the quarter was RUB 209 billion with RUB 21 billion of cash on hand resulting in the net debt of RUB 187 billion, which is two times leverage. Capex came at RUB 5 billion which is much lower compared to the same period last year, due to lower investment in expansion and redesign during lockdown months.

Now a bit more of a detail on quarter developments. Sales growth was again driven by strong like-for-like in the mature stores. Despite slower expansion, sales growth remained double-digit in each month of the quarter supported by performance of like-for-like stores. 14% sales growth was a combination of LFL sales growth of 7% and selling space growth of just over 5%. The main contribution to LFL flow came from the mature stores, the stores opened before 2018. At the same time, younger stores continue delivering strong double-digit LFL sales growth. Quarter specific trends included no stockpiling effect. Shifting customer demand from dry food to fresh food, especially fruits and vegetables, lower visits frequency due to pandemic environments, higher average spend per visit, overcompensating with weaker traffic and rewarding our efforts of category management and increase of average number of articles in the baskets and low single digit on-shelf inflation versus deflationary environment in the previous quarter. Continuing trading-up with some upward trend throughout the quarter, we clearly see that value is the driver, composition of LFL sales growth gradually returning to normal, traffic growth improving with each consecutive month, while ticket growth decelerating with much slower pace. We are winning customers from other formats and an organized retail. Our market share increased from 9.6% last year up to 10.2% in the second quarter this year, strong sales driven by all regions with Northwest Siberia and Moscow, outpacing the rest. The South, which is the resort region, started actually showing acceleration only since the midst of June, while the home regions continued strong growth. Home-dining, work-from-home-regime, ban on foreign traveling and late start of domestic tourist season and warmer weather were key quarter specific trends pushing our sales higher. Overall, we estimate contribution of these pandemic-related efforts at around 2.8% on LFL basis in the second quarter. This again means significant improvement compared to pre-COVID months.

Promo intensity substantially reduced. The promo activity in the industry has eased with customers making preference towards better assortment value, service level and safety. We saw less bargain hunting and cherry pickers in our stores. And the promo sales went down y-o-y and q-o-q despite introduced discounts and zero markup initiatives on some socially important articles.

Magnit`s promo activity becomes more personalized. As the penetration of our loyalty card is growing and the benefits under the loyalty program gradually replace coupons, category discounts and sell-out.

Positive trading momentum continues in July, as it's not finished yet. In July, we continued observing strong overall trading results, and the sales growth continued by far outpacing space growth. The overall LFL sales growth shows further acceleration compared to the first and the second quarter, and this makes July actually the second strongest month of the year after March. Each segment operates with positive LFL sales growth with convenience and drogerie formats leading the race. We note continuous normalization of LFL composition with improving traffic, while spend per visit remains high.

Now I'll turn over the call to our acting CFO Dmitry to comment on financial results. Dima, go ahead.

**DMITRY IVANOV**

Thank you, Jan. And good day, everyone. And thank you for joining us. Let me take you through the details of our financial results. And I will start with gross profit. Gross profit margin improved by 58 bps to 24.4% compared to the same period of last year, and by 1.7 percentage points versus previous quarter. We had a positive impact from the following factors. First of all, we improved commercial terms with suppliers. Secondly, we gained on y-o-y slow down of promo share by 2.5%, which also came with better promo funding from suppliers and higher promo margin. Shrinkage improved by 77 bps despite increased share of fresh food and sales. Supply chain costs improved on lower transportation expenses. We also have several positive margin mixed effects, their increased share of cosmetics formats up to 8.1% versus 7.5% a year ago and wholesale segment with slightly lower share y-o-y of 2.1% versus 2.3%. We also note improved margin in the wholesales segment following assortment review. These positive factors were partly mitigated by the continuous investments into the loyalty program which in the second quarter reached 69 bps.

Now, a few words about SG&A. SG&A expenses were under strict control. SG&A percent of sales was down one percentage point, despite negative COVID impact of 39 bps, or RUB 1.5 billion. COVID costs were predominantly related to payments to frontline personnel, purchase of health and safety protection items like masks, gloves, sanitizers, etc. And finally, charity boxes provided to socially vulnerable groups of people. Personnel costs went up slightly on the back of increased payments to retail personnel during pandemic, which was partially offset by growing in-store productivity and record low staff rotation. Marketing expenses went down on lower promo activity and more efficient marketing tools. Lease expenses improved by 23 bps y-o-y and increase in sales density and better rates per square meter offset growing share of leased space, which was 77.4% in the second quarter. We are in progress offering renegotiating rental rates with landlords, as one of the several initiatives to counteract the impact of the outbreak. As of today, we have finalized negotiations and signed new contracts with about 40% of the target pipeline. Depreciation of assets as a percent of sales improved by 40 bps driven by growing sales density across all formats and slower expansion. Other responses also remained under control.

As a result, reported EBITDA margin recovered by 73 bps y-o-y and by 1.8 percentage points q-o-q, reaching 7.9%. For the second consecutive quarter, EBITDA margin is improving both y-o-y and q-o-q driven by gross profit margin recovery and better SG&A expenses. Adjusted for LTI expenses, EBITDA margin would be the same 7.9% due to partial release of last year accruals. Net interest expenses improved by 23 bps y-o-y thanks to reduced cost of debt. In the second

quarter, we had FX gain of RUB 1 billion related to direct import operations. As a result of factors mentioned above, net income doubled to RUB 12.8 billion with a margin of 3.3%. Effective tax rate was 20.6%.

It's worth to mention that growth came without increase of inventories versus end of last year. Inventories remained flat versus end of last year despite 16% sales growth in the first half, ongoing improvement of on-shelf availability, increased share of drogerie format, supplier inflation and stock-up activities in March−April. Trade and other payables reduced in the first half as a result of seasonal decline and bigger share of fresh categories in sales. We continued working on improvement of accounts payable and increased the terms of payments to suppliers by one day. Improvement of the working capital remains one of our top priorities for the second half of the year with some projects already in place. These projects are optimization of accounts receivables for bonuses from suppliers as a result of weekly tracking of overdue debt and clearing activities; switch to electronic document flow with large suppliers for marketing services and bonuses to reduce time required for document approval process; for trade inventory reduction, we arranged cross - functional collaboration of supply chain operations and commercial departments. We apply unique approach to different subgroups based on liquidity, as each part of stock requires its own treatment. For example, for slow moving items, we are working on volumes optimization, reviewing minimum order quantity with supplies. For passive assortment, we define optimal discount level. For promo in-outs, we are improving demand forecast accuracy. We have recently launched “pick-by SKU” solution in our DCs. Inside stores, we improved planograms, synchronizing shelf space with sales structure. And last but not least in this list, we have finalized piloting new IT solutions related to on-shelf availability and promo forecasting and plan to start rolling this out across the chain shortly.

A few words about our financial position. We are enhancing our financial position with substantial improvement of the cost of debt and debt duration. As of the end of the quarter, our gross debt was RUB 209 billion, which was RUB 10 billion lower versus Q1, Netted by cash position of RUB 21 billion, this resulted in the net debt of RUB 187 billion. Using the momentum of historically low market rates, we started to improve our debt maturity profile, while reducing cost of debt. Thus, duration of the debt portfolio increased from 17 months as of the end of March to 21 months in the second quarter. Debt profile has improved as well with long-term bank debt and bonds at 73% of total portfolio with dominant share of fixed rates. Cost of debt dropped to historical lows of 6.3%, down 1.4 percentage points y-o-y. With RUB 10 billion bonds at 7.85% coupon rate coming due December and some scheduled loan repayments at the year-end. We expect cost of debt to continue falling this year closer to 6%. Our leverage as of the end of the quarter was two times. We expect it to go down further in the next quarters. Overall, strong trading momentum and cash generation provides additional flexibility when considering ways of capital allocation and deleveraging as one of the options.

A few words about capex. Capex went down significantly on slower expansion and lower number of redesigns. Capex in the second quarter stood at RUB 5 billion, which was 58% lower y-o-y reflecting slower expansion and refurbishment problem during the outbreak. In the beginning of the year, we have spent RUB 12.3 billion on capex. And now I'll give the floor back to Jan to comment on guidance and provide some closing remarks. Thank you.

**JAN DUNNING**

Yes, thank you, Dima. Now, I would like to add some color on our digital transformation, as we made a big step forward in that direction. As you probably have seen, since May, we have a team of professionals led by Florian Jansen to accelerate our digital transformation. The idea behind

that decision was actually to increase the efficiency of our core business. And this will be achieved by reviewing and upgrading retail technologies, developing IT infrastructure and advanced analytics, searching and implementing new solutions. Big programs are, for example, ERP system implementation, the build-up of advanced analytic infrastructure, the end to end optimization of promo or the relaunch of our consumer app for loyalty and delivery. The team has quite a wide range of responsibilities and creating an omni channel customer experience is one of those. Going omni will help us to attract new customers, change existing customers' perception through elevated in-store experience. Part of our plan is to explore partnerships, like we do with Yandex and others. However, key is to strengthen the consumer brand and consequently, we will also enter into our new own pilots. Pharma is, as already mentioned before, one of the segments we see very optimistically. Grocery will also be tested through both express delivery and bulk purchase model. We test different missions and alternative operational setups to then pick the most efficient ones. This is also the most efficient as "capex-light" testing model is used. With around 22,000 stores and 59 million cardholders we are close enough to the customers and we have insight in their behavior. When required, we will ensure, we capture this opportunity and capitalize on our competitive strengths.

And now a few words on guidance for the year. In our initial guidance for 2020 you have already seen organic expansion slow-down as we wanted to calibrate the openings process more and ensure solid returns. Now as a result of the pandemic, we had to make a deliberate decision to proceed with selective number of new stores. The focus is on the products with the best returns. The updated guidance reflects soft expansion in the second quarter and implies around 600 organic store openings on net basis. The number of convenience store openings remains almost unchanged. But the development of the groceries has been scaled down more on the restrictions imposed in many regions on non-food retail and on continuous CVP fine-tuning and concept upgrade. Opening of some supermarkets has been postponed to 2021 given their long opening process. The adjusted redesign program reflects our approach to keep the stores open due to the better than expected sales. And we have started piloting a new discount concept with three stores opened in the regions and its everyday low price model with limited assortment of around 1,800 SKUs out of which 65 are in the price entry level and 18% of private label. We are looking into the format with low cost significantly reduced capex per store and high returns. We continue to look for bolt on acquisitions of small to medium size. And you may have heard about our recent deal with Evroros in Murmansk where we took over 89 stores, which we suppose to open until November. Given the above, capital expenditures for 2020 reduced to RUB 45 to 50 billion and it does not include M&As. Although the duration and impact of pandemic remains uncertain, we expect gradually scale-up of expansion plan of opening new stores in the next periods.

Now, some closing remarks. We continue to work on initiatives to drive sales, to improve efficiency and enhance overall competitiveness. Our main priorities remain unchanged and we keep our focus on LFL, on market regain, on a healthy balance sheet and working capital optimization. Thanks for listening. And we are ready for your questions.

**MODERATOR**

Thank you. If you would like to ask a question, please signal by pressing *1 on your telephone keypad now. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, that is *1. We'll pause for just a moment to allow everyone the opportunity to signal. It looks like our first question will be from Kirill Panarin from Renaissance Capital.

**KIRILL PANARIN**

Yes, hi, everyone, and thanks for taking my questions. Two questions from me, please. Firstly, a few things to clarify on gross margin. Were there any other factors except investments in the loyalty program that did offset the positives in Q2? And do you expect the negative impacts of loyalty program investment to moderate going forward? And lastly on this, to what extent do you think the current gross margin level could be sustained into the second half of the year? That's my first question.

**JAN DUNNING**

Yes, thanks for the question. To be quite honest…If you talk about the biggest impact on gross margin negatively, that has been the loyalty program. There's been another aspect as well, which is the margin on the loyalty program that we had in non-food with pots and pans, but that's not as big as the loyalty program that we had with the card. Then part of the question was also whether we see bigger investments coming. It is clear, which I also mentioned on the digital transformation, that the loyalty introduction is extremely important for us to get data and to start to understand our customers better. We believe that that's a healthy investment. And there's actually a compensating part of the underinvestment that we do in marketing, as we are able to reach out directly to customers. I trust that there isn't a chance if we are able to get the penetration higher than this in the current 66% of sales that we will have to invest a bit more. But I also believe that it's going to be compensated by our ability to reach out the customers better and therefore on top line we will see improvement. Then the second part of the question was, whether we see the gross margin develop for the rest of the year. Given the market, and I hope that stays as it is. We've seen less pressure on promo and we see that way as well. But the consumer is no less oriented on promo but more on value and more on health. If that stays the same, we believe that in the current mix of composition of our margin, we will potentially stay as it is.

**KIRILL PANARIN**

That's clear. Thank you. And then secondly, it would be good to get a bit more color on your capex guidance. How much is attributed to expansion and redesign versus IT versus other? And how do you assess your current level of investments into IT and online initiatives? Do you think you need to increase your capex in these areas over the next 12 or 18 months? Or the current level is sufficient? That's it from me. Thanks.

**JAN DUNNING**

We have in our current budget of capex; we have allocated quite a lot of money already to IT with regards to ERP but also digital transformation. In our capex there is also a sizable amount for logistics, which also by the way includes F&R (Forecasting and Replenishment) and Goods management system implementation. We will try to spend as much as possible on expansion and the growth. And it's primarily given the results that we currently post. It is something that we really look forward to. In total, there is around 35% of IT and projects of capex allocated to them. And in the plan there is around 20 - 23% to new openings and remodel. And the rest is maintenance and logistics.

**KIRILL PANARIN**

Okay, that's great. Thank you.

**MODERATOR**

Thank you. Our next question will be from Henrik Herbst from Morgan Stanley.

**HENRIK HERBST**

Yes, thanks. Thanks very much. I just want to get back to ask a couple of things you mentioned. Firstly, in terms of your plans for faster expansion, I was just wondering if you could give a little bit of color on that. Are you thinking we go back to your original plans for 2020? Or could you get back to levels seen sort of 2019-2018 we saw significantly higher? And then, in terms of that as well, is there any format in particular or is it sort of across the board and you can reaccelerate the store expansion? And then secondly, I was just wondering if you could give a bit more color on the LFL growth in July? I think you mentioned that it was, if I heard it correct, 2.8 percentage points benefit from sort of COVID-related phenomena like food at home and working from home and all that. Presumably that sort of just accelerated in July even though I guess restrictions eased a bit. Can you maybe explain a little bit why you think that growth accelerated in July? Presumably as well, your comps on LFL or it is getting a little bit tougher. Towards the second half, as the business did a little bit better, I guess, H2 last year. Thanks very much.

**JAN DUNNING**

And now let's first be clear on growth. And I think that wasn't changed that I introduced last year. I am strongly in favor of growing but I want profitable growth, I want returns. We have scaled down our growth for this year in comparison to the year before for the simple reason that I didn't see a pipeline that would deliver the returns that I have in mind. So, that meant that the whole setting of the development and the search for locations had to be changed. And what we see now is that we are capable of getting better locations, but also our stores and store densities are growing and therefore, there are also more locations available. And that means, that I believe, that there will be more profit coming out, because our store growth is not limited by willingness, our store growth is limited by the fact that we have certain criteria that we want to achieve with growth. I believe that we should be able to get an action beyond the plan that we had for 2020-2021. That is at least our ambition level and I believe with the current trading and development that we get there. A clear signal given to the development team is now to speed up and to beef up the organization to make sure that we are capable of opening more in 2021. And on top what I also think is important and also what I mentioned already earlier, of course, the market is diverse, there are markets where there are still lots of opportunities for organic growth, but there are also markets where we clearly have to replace.

That means that also the M&A activities have to speed up and actually have to step up. And one of the results therefore is the announcement on Evroros that we did last week, which is an acquisition that we did. And I think that's very good for the organization to get in there. And it's also good for the markets that we enter because we are replacing; we're not putting on top square meters. In a nutshell, there is a big desire to grow. But with brains. We want to see good returns and profitable growth. We are beefing up the organization to be able to grow faster next year. And for this year I have adjusted the growth pattern as that's currently the pipeline I'm looking at but we will try to do our best to exceed do that as well. And then on the LFL, by the way, the format question was also there, so that for next year, as you have seen, we see actually successful sales density increase in all the formats, which means that we're not excluding growth in any of the formats for the next year. But looking at the cosmetics business, which is actually quite exciting, I think we should keep a focus on the cosmetics business with regards to expansion. But also our convenience and supermarkets are doing very nice. They're also those should be taken care of.

Then the LFL in July. We knew that we had challenges in third quarter. Maybe you recall, last year, that was not the most exciting quarter that we were presenting. So we know that we have challenges in July and August, and then September is a bit more competitive, but I still believe

that also last year we had good performance. I'm slightly optimistic on the third quarter. We're preparing a pretty good plan. We see the efforts of our category management have really paid off during the COVID. And we see also in July that actually the traffic starts to normalize and there are days that we have with positive traffic. But we see a very strong, and it maintains very strong, basket. We believe that consumers have recognized that Magnit has become an interesting shopping location and we'll do everything to keep that and improve even further. Bear in mind, there is still a lot to be improved in our business. We're not there yet. The impact of COVID, which was in July, we haven't measured that yet, but the impact of COVID for the second quarter was 2.8%, which came down if you compare it to the first quarter March. We have seen month-by-month the impact is declining. That's because the market is normalizing more and more.

**HENRIK HERBST:**

Thanks very much. Can I just very quickly clarify one thing on the expansion when you were more optimistic… Is that in gross expansion or net, or both? It sounds like you probably could keep a few of the stores you plan to close - open. Did I get that right?

**JAN DUNNING:**

Exactly. You got that right. Because of the whole performance improvements, we see that stores that were planned to be closed, actually, if you do the recalculations now, it makes sense to keep them open.

**HENRIK HERBST:**

Alright. Is it actually net more optimistic than gross, which, I guess, is, from a financial perspective, higher return. Thanks.

**MODERATOR:**

Thank you. Our next question will be from Max Nekrasov from Goldman Sachs.

**MAX NEKRASOV:**

Good afternoon. Thank you very much for the presentation. I have a couple of questions. First one on a bit clarification on margins. I was just wondering what percentage of margin improvement was driven by lower promotions in the second quarter, and whether you believe you should see more pressure in terms of promotions once consumer behavior normalizes and people start visiting stores more often, and show more active cherry picking somewhere in the future.

**JAN DUNNING:**

Let me put it like this. We have seen a couple of factors and I don't want to decompose the margin to all elements. So what has been good for us? What's good was we have been fighting waste, the program that we put in place to keep and get shrinkage under control has helped, and that's actually the main factor. And the second factor was we've been much better able to pull in and buy the subsequent volumes for the promo periods and therefore get better promo compensation than we did last year. The third one was we have a couple of points lower promo share that also helps to contribute to the margin. And then the third one which is slight, it is there, is the mix change between the different formats. Then, of course, we have a couple of negatives and that led then in total to 58 basis points improvement.

**MAX NEKRASOV:**

Thank you very much. Do I understand correctly from your comments that for now you don't really see any need for accelerating promotions and the price investments?

**JAN DUNNING:**

Like I mentioned, we see a very good July month. We hope that the retail environment stays rational and that the competitive pressure does not increase. Of course, we will react if needed. But for now, in July, there is no reason for me to feel that we have to increase the promo.

**MAX NEKRASOV:**

Thank you very much. I also wanted to follow up on the M&A question. Do I understand correctly that you see M&A become as a more important tool for your expansions as the market's maturing? Basically, what are the key features that you're looking for in the possible targets in terms of locations, formats, size of the companies?

**JAN DUNNING:**

I don't think that I am prioritizing in how we grow but I do believe that the market in itself over time, will go more in replacements than organic. As I identified it, I think we should not exclude that we're going to look at existing smaller players in the regions that we would like to acquire. But I also would like to grow organic still because there's also lots of new developments in the country where we see opportunities to build or to open up stores as well.

**MAX NEKRASOV:**

Understood. Thank you very much.

**MODERATOR:**

Thank you. Our next question will be from Yulia Kazakovtseva from UBS.

**YULIA KAZAKOVTSEVA:**

Hi, this is Yulia. Thank you for taking the question. I have a question regarding your new format — discounter. Could you please comment on how much do the prices in these discount stores could differ from your regular store?

**JAN DUNNING:**

Let me first explain "why", because I think that's an interesting part as well. As you know, Magnit had always the image of being a discounter, but, actually, it was a convenience business and what we're currently building is we're going back to the roots of "we want to be a convenience business", which is focus on the offer, focus on the width of the range, also in the price tiers, et cetera, and make sure that we are very strong in fresh. Now, some of the stores that we have ,which we are analyzing and potentially we're thinking, should we close them or not, were on locations which normally would be very suitable for the discount formula. And as you probably know, Magnit is not only a retailer, it is also a producer. We have 11 factories and we have four agricultural complexes. So why not use those productivity or production facilities for our discount model and that's what we started to do. So we called the discount model "Moya Tsena" which is "my price". We put in our own production plus entry-level of the suppliers, and I think the average price level is around 15% lower. Bear in mind, we have only three stores. It's a very big test as you can see, but what we have seen now, and also that is that the stores are open just, I think, four weeks, it looks like that's a model that works. Just to give an example That's a real good

example because those were Magnits with old pricing and old offer. One of the store is actually doing double the sales of what it did before. And all of the stores are making more sales than what they did before. It needs more time, it's too premature. It needs more time, but if this is the development that we see going forward, we should extend the sample and see if we are looking at a business that we would like to develop further.

**YULIA KAZAKOVTSEVA:**

Thank you.

**MODERATOR:**

Our next question will be from Egor Makeev from Raiffeisen Bank.

**EGOR MAKEEV:**

Good afternoon and thanks for the call. I have a couple of questions. My first question is do you expect the improvement in lease costs that we already saw in second quarter and will likely see later this year to be sustainable in longer term, or it will be sort of one-off of this unusual year?

**JAN DUNNING:**

For this year, I think it's sustainable. For the year after we have to see. We have also reduced the rates for sublease. We got from certain landlords, as well, corrections of the lease, but that's not eternal, but in the lease, you always renegotiate and renegotiate and renegotiate. I will be heavily disappointed if this is not sustainable.

**EGOR MAKEEV:**

Ok. Thank you. And just a small follow up on this one. Is there any timeline or period when leases are usually renegotiated or it's done on ad hoc basis?

**JAN DUNNING:**

Like I said, that's actually an annual exercise. By the way, it's also depending on certain return criteria, if you feel that actually the sales densities are good, but the EBITDA relation to rent is a bit in favor of the landlord, then you'll share that with him and say, “Okay, listen, can we get back to normal?” In the retail landlords and retailers are always discussing rent, that's a part of the game.

**EGOR MAKEEV:**

Yes, thank you. Understood. And my second question will be on Magnit Cosmetics. Well, this format already seems to perform pretty well. I just wonder in what direction do you want to update its CVP and concept and what targets do you want to achieve by this?

**JAN DUNNING:**

I'll explain. It's a bit technical. We have Magnit Cosmetics in different sizes. And what I want to improve is that we get concepts in place. The Magnit Cosmetics in the village should simply look different than Magnit Cosmetics in Moscow. Magnit Cosmetics in Moscow in one of those shopping streets should look different than the Cosmetics in one of the sleeping districts, because the demands are different. And if you define it, then we can also build certain formats within the cosmetics so that we improve its performance. But also we should deliberately be looking for different formats size-wise in the towns. Just as an example, we have a cosmetic store of 60

square meters. It's on the market and it has some of the highest sales densities in the network. But if I ask the development guy “what are you looking for?” “I'm looking for the cosmetics.” He will be looking for 350 square meters. Based on what? Why can't we do 150 square meters? The CVP is exactly that exercise to improve the concept by format within the Cosmetics chain. I think we have opportunities there. The CVP is also to identify in our current assortment range what do we lack or which categories we are actually not strong enough in comparison to the peers, but also in comparison to the market. I think, CVP is nothing else than updating and improving your customer value proposition, which looks at assortment, category range, it looks at pricing, it looks at promotion, it looks at signage, it looks at shopping experience. I'm working long time in the retail — that never stops. That’s just a wheel that turns. You have to be critical because otherwise someone else takes over.

**EGOR MAKEEV:**

Thank you. It makes sense.

**MODERATOR:**

Thank you. Our next question will be from Irina Fomkina from ITI Capital.

**IRINA FOMKINA:**

Hello. Thank you for taking my question. Could you please tell us what is your view on the partnership with Yandex.Lavka? Is this project successful, profitable? How big is the commission payable to Yandex.Lavka and vice versa? What are Magnit’s plans to develop its own delivery?

**JAN DUNNING:**

The background of Yandex.Lavka was the following. First of all, we were not an e-commerce player at all. The general thinking was actually…because the concept - the customer value proposition that we have with our convenience store is not interesting for e-commerce because our customers aren’t e-commerce customers. That was the hypothesis. How to find out is to connect to an existing player, Yandex.Lavka, and built simply a concept based on our assortment. That's what we did. We made a Magnit store on Yandex Lavka and had to look if there was demand.  Actually, we were surprised because the number of orders was quite impressive. It helps us then to convince the organization that e-commerce potentially might make sense. That’s why also the whole presence of Florian helps and the digital team, but also the operational guys and the commercial guys have been actually quite active in developing in that project, but also in other projects. Now, the second part of your question is own delivery. The day before yesterday, we passed successfully our technical test of e-Pharma. So technically the ordering, the collecting and the dispatching worked. We believe that by September we will have our Magnit Pharma as an e-commerce channel as well. We would like to develop further and see in November the first pilot with our grocery business. Those are small pilots, but we definitely want to move into that direction. Although, let's be honest, that's not going to change the needle on profitability or sales. Cause it's a minor element, but for the year after as well, I think, as a modern retailer, we want to be in that segment as well. I think that's also the strength of Magnit, because if you look at Magnit, we are the business that is able to run and has an organizational structure that is able to run multi formats, but also different types of businesses like cosmetics, hypers, supers, convenience, city model and also the discounter.

**IRINA FOMKINA:**

Thank you. Could you please be so kind and answer one more question, if I may? When do you plan to finalize rebranding of your stores? Could you please go into the incremental rebranding costs per store? And could you please comment on the incremental costs for new store opening in case it is owned store and it is a rented store. Thank you so much.

**JAN DUNNING:**

With the rebranding. We will continue doing the redesign. We have so far done 70% of the network, so there's 30% left. What I think is if you have the amount of stores that we have, by the time that we are finished, I think we'll start again, because then we've done for the last five, six years remodel. And I think the store or convenience store in the current times needs a continuous attention and it also fits by the way in the development of the CVP. The CVP is not something that you develop like "this is my customer value proposition, and now it's ready, and for the next 10 years I don't need to look anymore." The CVP is a continuous process in which you need to change looking at market trends, looking at competition performance in which you change you offer, in which you change your presentation, in which you change your communication. And I think that will continue. What is really important is that something that we introduce new… We are not doing the redesign for redesign. I want to see the redesign also has a relative normal return. So how much money do I put in and what do I see as the sales uplift? So far we've seen as well, that in quarter four and quarter one, the remodelings that we have done have seriously proper paybacks, returns. And therefore also we will continue doing rebranding and redesign, but the 30%, which means that we are looking at around 7,000 stores, we will need still a couple of years to redesign them.

**ALBERT AVETIKOV:**

And just a small addition on capex per square meter. We disclose that in our quarterly results presentation for both rented and leased stores. So for modeling purposes, I would advise you go through the presentation.

**IRINA FOMKINA:**

Thank you.

**MODERATOR:**

Our next question will be from Elena Jouronova from JP Morgan.

**ELENA JOURONOVA:**

Good evening, ladies and gentlemen. First of all, congratulations with very strong results. A great effort by the entire Magnit management team. I have two questions and the first one is for Dmitry, actually. So Dmitry, I wonder what is your best case and bare case for cash extraction from working capital this year?

**DMITRY IVANOV:**

Elena, thank you for the question. Of course, we have several scenarios for short term and for long term. In these scenarios, we put almost all our measures that we have now in place with regard to cash generation, namely, improving of working capital, improving inventories, measures that already mentioned by improving trade receivables. We now are quite optimistic with our outlook on cash generation mostly from working capital, I would say.

**JAN DUNNING:**

Can I add something there as well? Because when I spoke on the last call, I told that we were working on a plan. We are very excited with the results, and I think they're sustainable, but we're not there yet. There's a lot of things still to improve. One of them is working capital. What we started with in the second half of last year was get traction with our customers. So get traffic up by cleaning up stock, getting better ranges on the shelf, the whole marketing and assortment improvements were all done in the second half of last year. That came at a cost, and I was not satisfied with the margin capitalization. Then this half year we've spent on regaining margin. As we built very good conditions with the suppliers, how come we are not able to make money out of these? So that you see as the result, the gross margins are improving, the costs are improving, and that leads to EBITDA margin that we today have presented. Now, the next thing is working capital, because, if you see, we still are rich in stock and we now have started a bit of pretty advanced insight into what is the composition of our stock, what is the composition of our stock in the MM – the convenience, what is the composition of the stocks in the cosmetics, in the pharmacy, in the hypers, in the supers. And how can we make that turn faster? And how can we reduce that as well? How can we adjust the order quantities, but also the order size to make sure that we keep less stock inside the stores and in the DCs. That activity has started in the beginning of June. That's why you see that the payables at the moment are also low at the end of the quarter because we have been cutting stock quite a lot and, therefore, relatively set buying less in June. And therefore, we're also reporting lower payables, but that's just the efforts of working on the working capital. I think that you will see us improve there as well. Although I want to warn you that my ambition is now to come down with stock, but that is a very tedious and complicated exercise. The quickest you can turn down stock is on A - the fast movers, but that is also dangerous for your sales. We're taking that under control.

**ELENA JOURONOVA:**

Thank you very much for a detailed answer. And my second question was more about capital allocation going forward. So, it seems like this year is slightly better in terms of, or much better, in terms of operating cashflow and your CAPEX is falling. Any preliminary thoughts about dividend payment for this year? Do you see the case for your dividend distribution to be much higher than last year?

**JAN DUNNING:**

Just technically, it is not a decision of the management. I think, the Board can go with the proposal, and then the shareholders approve to give them pay. But I have another wise argument in this field as well. I believe in such good returns, that it also makes sense to think maybe we should spend a bit more on CAPEX.

**ELENA JOURONOVA:**

Ok. Understood. Thank you very much, and, once again, congratulations.

**MODERATOR:**

Thank you. It looks like our last question will be coming from Marat Ibragimov from Gazprom Bank.

**MARAT IBRAGIMOV:**

Thank you very much. My sincere congratulations to your results. I have a question on your gross margin, gross profit margin. In the press release, you mentioned such an explanation for this expansion is a better promo coverage. Could you please explain that for me? What do you mean?

Do you mean that you are now switching to targeted promo offerings to your customers through your loyalty program and you are not providing widespread promo which destroys your gross margin? Can you please explain?

**JAN DUNNING:**

I will explain my part. I think, Dmitry will help me. What we noticed is that, although we had good conditions with the suppliers, we were somehow not able to keep that. And then in the analysis that we did, and it's very simple, if you do a promo and you plan to sell 20, then it is smart to also buy with discount in invoice 20, and potentially 20 and a half. If you then only buy 10 and you're selling the 20, then additional 10 that you sold, but not bought is coming at a regular price. And then you invest that discount yourself. Do you understand? So promo coverage is to make sure that your planning is much better.

**DMITRY IVANOV:**

Let me add to this. This was just better coordination between your selling volumes on promo and your buying volumes on promo, and, also, coordination of discounts you received from your suppliers and discounts you grant to your customers. Out of this back of coordination, we get better promo coverage in our gross margin.

**MARAT IBRAGIMOV:**

And you achieve that through IT… what was the driver of that more efficient promo?

**DMITRY IVANOV:**

There are several tools to do this. Of course, it's support of IT and several IT projects which help us to improve promo demand forecast accuracy, and also it's everyday collaboration of commercial and logistics teams, as well as the long-term planning with suppliers on volumes for promo.

**MARAT IBRAGIMOV:**

Thank you very much. And my next question to Dmitry on working capital. To be more specific, on accounts payable. Indeed, it was lower as of June 30, compared with the beginning of the year and also in terms of days payable you manage to significantly reduce it. It looks like you bargained a shorter payment terms to your suppliers in exchange for better prices from your suppliers. Can you confirm that or I'm doing the wrong conclusion? Thank you.

**DMITRY IVANOV:**

I think, and I am hundred percent sure, this is wrong perception of what we did with payables and our gross margin. As I've already mentioned, our trade payables reduced, comparing to the end of last year, due to seasonal factor and it's normal for almost all retailers, when we are buying quite a lot for high season in November and December, and we pay these volumes in January and February. Thus, our payables volume is also decreasing. This seasonal factor this year coupled with higher share of fresh products in our sales. And according to Trade Law prescription, payment days for fresh products are a bit less than for dry products. Comparing our payables with the end of second quarter of last year, we are flat cause practically we have the same pattern, and there was also a technical factor, we call it "quality of payment day." If you look at calendar, last year, June 30 was Sunday. It means, given that we are paying every day, we paid on Friday means that we had two more days of purchases — Saturday and Sunday. For this year, June 30

was Tuesday, meaning that we didn't have this advantage. But this is just technical. Fundamentally, this decrease in payables, it is more technical, it is more kind of structural impact.

**MARAT IBRAGIMOV:**

Thank you very much. That's it from my side.

**MODERATOR:**

Thank you. There are no further questions at this time.

**ALBERT AVETIKOV:**

Thank you. And with that we finish the call. Thanks everyone for joining and just to remind you, we will disclose our IFRS results on August 20. Thank you.

**MODERATOR:**

Thank you, ladies and gentlemen. This concludes our teleconference. You may now disconnect.